

General Information Letter: Severance pay included in federal adjusted gross income is included in base income.

September 17, 2003

Dear:

This is in response to your email dated August 21, 2003 addressed to the Office of the Governor. Your email has been forwarded to the Illinois Department of Revenue for a response. Your email states as follows:

I was one of the unfortunate Americans to be laid-off from work. My question to whom ever this pertains is, "Why is severance pay taxed?". I know it is considered income, but severance is a HARD LUCK payment and it should in its entirety go to that persons family. A person receiving severance means they no longer have a job. Until they can find another job all the money they receive is welcome and I do not think it should be taxable. The way the economy is today jobs are hard to come by. "Outsourcing", this is a term that is being used all over. Businesses are going over seas to obtain services cheap, this is not a way to help the economy. Can you somehow address this?

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Your letter acknowledges that severance pay is considered income. You are correct. Section 1501(a)(3) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) defines the term "compensation" to mean wages, salaries, commissions and *any other form of remuneration paid to employees for personal services* (emphasis added). The Illinois Administrative Code further describes the statutory definition of compensation in 86 Ill. Adm. Code 100.3100(c):

The name by which remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, and pensions and retired pay are compensation within the meaning of the statute if paid for services performed by an employee for his employer.

86 Ill. Adm. Code 100.3100(d) states:

Remuneration for personal services constitutes compensation even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them, so long as such relationship existed when the services were rendered.

Pursuant to these provisions, severance payments are considered "compensation" for purposes of the IITA, and are taxable in Illinois if "paid in this State" under IITA Section 302(a).

86 Ill.Adm.Code 100.3120(a)(1) states that compensation is paid in Illinois if:

- (A) The individual's service is localized in Illinois because it is performed entirely within Illinois;
- (B) The individual's service is localized in Illinois although it is performed both within and without Illinois, because the service performed without Illinois is incidental to the individual's service performed within Illinois; or
- (C) The individual's service is not localized in any state but some of the service is performed within Illinois and either (i) the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within Illinois, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Illinois.

86 Ill.Adm.Code 100.3120(b) specifically provides that compensation paid for past service shall be considered paid in Illinois:

Where compensation is paid to a nonresident for past service, such compensation will, for the purpose of determining whether and to what extent such compensation is "paid in" Illinois and is allocated to Illinois under IITA Section 302(a), be presumed to have been earned ratably over the employee's last 5 years of service with the employer ..., in the absence of clear and convincing evidence that such compensation is properly attributable to a different period of employment ... Compensation earned in each past year will be deemed compensation paid in Illinois if the individual's service in such year met the tests set forth in [100.3120(a)].

We realize times are extremely difficult for unemployed taxpayers. Nonetheless, severance payments are fully taxable pursuant to Illinois law. Until the law changes, severance payments will continue to be taxed. You may wish to address this issue with your state representatives.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax